

# Private Self-Employment under Reform Socialism in Cuba

**Mario A. Gonzalez-Corzo**

The City University of New York

**Orlando Justo**

The City University of New York

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## Abstract

The expansion of private self-employment is one of the main economic measures implemented by the Cuban government since 2010 to update its socialist economy under a unique brand of “reform socialism.” State policies (a “push factor”), as well as economic incentives and the desire for greater economic independence (“pull factors”) have contributed to the remarkable growth of self-employment in Cuba since 2010. While employment in the state sector has declined significantly (13 percent) since 2010, self-employment has grown by more than 187 percent, and its share of total employment has increased from 3 percent to close to 9 percent. Despite these advances, Cuba’s self-employed workers face significant obstacles that limit their growth and potential economic contributions. In addition to addressing these challenges and obstacles, ensuring the success of Cuba’s self-employment reforms requires reconceptualizing the state’s attitude toward self-employed workers and their potential contributions to economic development and growth.

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*JEL Codes:* P21, P23, P27, P30, P31

*Keywords:* entrepreneurship, self-employment, transition economies, Cuba

## I. Introduction

The expansion of private self-employment is one of the principal economic reform strategies implemented by the Cuban government to “update” the country’s socialist economy. In spite of being tightly regulated, private self-employment has been tolerated and used cyclically in periods of economic recessions since the 1959 Cuban revolution (Jatar-Hausmann 1999; Pérez Villanueva and Vidal Alejandro 2012). It was one of the principal economic reform measures implemented to cope with the economic crisis caused by the fall of the communist bloc (Carranza Valdés, Gutiérrez Urdaneta,

and Monreal González 1996; Jatar-Hausmann 1999; Mesa-Lago 1994; Perez Villanueva 1998, 2010; Ritter 2004), and this sector has experienced an unprecedented revival since 2010. Unlike past attempts, which tolerated some limited forms of private self-employment in a few economic activities, the reform measures implemented since 2010 represent a deeper transformation of this vital sector of the Cuban economy. As Pérez Villanueva and Vidal Alejandro (2012) note, this process has been driven by the need to reduce inflated state payrolls and by increased official acceptance of private self-employment as a viable alternative to employment in the state sector. The reduction of the state's share of total employment, combined with the implementation of policy measures to promote private-sector self-employment and to gradually transform other areas of the Cuban economy, suggest the transition from the excessively paternalistic and centralized classical socialist model to a uniquely Cuban form of reform socialism.

This paper analyzes the recent evolution of self-employment under reform socialism in Cuba. Section 1 discusses the principal characteristics of reform socialism, with a particular emphasis on private-sector expansion, reforms to improve the performance of state-owned enterprises, and the gradual modification of the price system. Section 2 examines the evolution of Cuba's emerging self-employment sector since the reforms in 2010 and the principal challenges confronted by these workers. Finally, section 3 presents the study's conclusions and discusses future prospects for private self-employment as the Cuban economy continues to transition from classical to reform socialism.

## **II. Principal Characteristics of Reform Socialism**

The transition from bureaucratic to market coordination that took place in reforming socialist countries (e.g., Hungary and Poland) after the de-Stalinization of their economies in the late 1950s and early 1960s was initially based on the "conception of reform as a mix of plan and market within the State sector" (Stark and Nee 1988). In the case of Hungary, the process, commonly known as "reform socialism," expanded with the introduction of the New Economic Mechanism (NEM) in 1968, paving the way for "a conception of reform as the transition to a mixed economy of public and private property forms with implications for the emergence of new social groups and autonomous social organizations" (Stark and Nee 1988).

According to Stark and Nee (1988), under this reconceptualization of reform socialism,

The socialist state would control the commanding heights of the economy, regulating the market mechanism by manipulating investment credits, amortization rates, depreciation allowances, interest rates, prices, wage structures, and other macroeconomic controls. With the correct mix of plan and market, the market mechanism would not generate spontaneous economic processes but instead would serve as an instrument to reduce the transaction costs of central planning. In short, early reformers believed that the most efficient governance structure for socialist economies was a combination of market and central planning.

Kornai (1992, 2008) defines “reform socialism” as “regimes that differ from the Stalinist model of classical socialism in several important aspects” and have “made some steps towards liberalization in the political sphere, somewhat decentralized the control of their State owned sector, and allowed some larger scope for the private sector.” Under reform socialism, however, the fundamental attributes of the socialist system are preserved: the Communist Party retains absolute political control and does not share its power with any other political actors; the state retains ownership of the fundamental means of production; and bureaucratic, centralized planning remains as the principal coordinating mechanism, even though market-oriented mechanisms are introduced in some sectors of the economy (Balcerowicz 1989; Chilosi 1992; Kornai 1992; Nove 1989; Shleifer and Vishny 1994).

Reform socialism permits some degree of political liberalization but maintains the Communist Party’s political monopoly (Chilosi 1992; Kornai 1992; Nove 1989). Likewise, it allows the introduction of some market-based performance metrics (e.g., profits, and material incentives) to improve enterprise efficiency, and the reduction, but not the complete elimination, of centralized decision making. It also allows the introduction of decentralized prices in some sectors of the economy, as well as the creation of alternative spaces to facilitate the nonstate sector’s gradual expansion. Nevertheless, reform socialism, in its various manifestations, retains core elements from the classical socialist system (Balcerowicz 1989; Nagy 1989; Nove 1989). These include “pervasive price controls, bureaucratic restrictions of enterprises’ entry into new markets, massive inter-enterprise redistribution of financial means via the budget, and (the presence of)

Party-State “nomenklatura” with respect to the managers of enterprises, banks, etc.” (Balcerowicz 1989). In other words, despite the alleged benefits of some private instruments, the absence of externalities in consumption and production, relatively low information costs, and the provision of private goods rather than public goods, reform socialism prioritizes public or social property forms over privately owned property.

Reform socialism allows the introduction of market-based coordination mechanisms to complement bureaucratic, centralized, planning in order to improve or “perfect” the classical socialist model (Brus 1972; Nove 1989; Kornai 1992; Weisskopf 1996). As Brus (1972) indicates, under the reform socialist model “the means of production (capital) are publicly or collectively owned, and the allocation of resources follows the rules of the market.” To improve economic efficiency, reform socialism tolerates the existence of collective property forms, managed according to market principles (Brus 1972; Balcerowicz 1989; Lange 1938; Nagy 1989). The proponents of reform socialism believe that collectively owned property ensures equitable resource distribution, while market-based coordination mechanisms contribute to economic efficiency, improvements in total factor productivity, and the rational use of the factors of production and other economic resources or inputs (Lange 1938; Lerner 1944). Even though collective (social) ownership is considered as the principal property form under reform socialism, other property forms (e.g., individual or joint property, cooperatives, and mixed enterprises, including joint ventures with foreign-owned firms) are permitted under reform socialism (Brus 1972; Lavigne 1989; Nagy 1989; Szamuely 1989; Fischer and Gelb 1991).

The private center’s emergence from the shadows to center stage is another important characteristic of reform socialism (Brus 1972; Fischer and Gelb 1991; Kornai 2008; Stark and Nee 1988). Prior to the reform process, most economic measures in socialist countries focused on increasing state-owned enterprise (SOE) autonomy and on introducing limited “material incentives” to improve their efficiency and profitability (Hinds 1991; Kornai 2008). Although some small-scale, peripheral, private-sector activities were permitted or tolerated (many times reluctantly) under the classical socialist system, the emergence and evolution of the private sector, and its growing share of economic activities, are among the main characteristics of reform socialism (Kornai 1992, 2008).

The majority of private-sector activities under reform socialism take place in agriculture (Nee 1989; Kornai 1990). Notable examples include China's "family responsibility system" (implemented in 1978); agricultural production and sales from privately owned family plots in Hungary, Yugoslavia, Poland, and Vietnam; and more recently, in the case of Cuba, agricultural production and direct sales of agricultural products by nonstate entities (e.g., cooperatives and private farmers) under Decree-Law 259 (passed in 2008) and Decree-Law 300 (passed in 2012). Private (nonstate) activities also expand in other areas of the economy—such as construction, retail trade, transportation, and personal services—under reform socialism. In many instances, these activities are performed to supplement employment (and earnings) in the state sector in the form of "moonlighting" and "do it yourself" work (i.e., economic activities that are typically associated with the small-scale forms of self-employment tolerated by the state) (Dallago 1989; Davis 1988; Grossman 1977; Kornai 2008; Pomorski 1988). Renting out private homes and apartments, and deriving income from other "rental activities" such as private car rentals, as well as a wide range of small-sale, service oriented, entrepreneurial activities are also allowed by the government under this package of measures (Dallago 1989; Davis 1988; Grossman 1977; Kornai 1990; Kornai 2008; Pomorski 1988).

Once state-imposed restrictions are eliminated and the official discourse formally accepts the private sector's existence and the market's role (albeit limited) as an alternative allocation mechanism, the private sector's expansion under reform socialism occurs spontaneously (Kornai 2008; Stark and Nee 1988). Economic actors are attracted by the higher earning potential and the relative autonomy offered by the private sector, which emerges not only as an alternative source of employment and income for a growing share of the population, but also to meet the demand left unmet by the often bloated and less efficient state sector (Kornai 2008). The "inner contradiction" of reform socialism associated with the private sector's expansion emerges from the state's ambivalent attitude toward the private sector under reform socialism. As Kornai (2008) indicates,

Despite some improvements (under reform socialism), the daily life of private business is still marked by a multitude of bureaucratic interventions and restrictions. The private sector has limited access to supplies of materials and almost none to credit or foreign exchange, so that these are often acquired in

illegal or semi-legal ways. A further sign of hostility is jealousy of people observing the widening income differentials. This envy of individuals who suddenly come to earn more than others occurs under all systems, but it is likely to be all the more divisive in a society where people have been brought up to consider equality a major social desideratum. Finally, other difficulties are caused by the absence of legal institutions to provide consistent protection for private property and enforce private contracts.

Private-sector activities are also constrained by excessive taxation and by limits on the accumulation of private capital and/or property (i.e., by laws and regulation that prevent the concentration of wealth in the hands of the emerging private sector). Excessive or onerous taxation of private activities keeps the private sector under the state's control, but it comes as a high economic cost (Kornai 1990). The same is true of legal prohibitions against the accumulation of wealth, of which the constant threat of confiscation or nationalization by the state is the most powerful form (Kornai 2008). Paradoxically, as Kornai (2008) observes, prohibitions against the “concentration of riches” (or wealth) in the hands of emerging private economic sectors is ideologically rooted in a principal tenet of Leninist thought: “Small production engenders capitalism and the bourgeoisie continuously, daily, hourly, spontaneously, and on a mass scale” (Lenin 1920). From the state's viewpoint, “if society allows for the existence of a large number of small commodity producers, and if it permits them to accumulate capital and grow over time, a genuine group of capitalists will emerge sooner or later” (Kornai 2008), leading not to the reform of socialism from within, but to its eventual demise.

In contrast to the creation of the state sector, and the quasi-state sector under the classical socialist system, the private sector's emergence under reform socialism is not an “artificial creation” by the state (Kornai 1992). Instead, under reform socialism, the private sector emerges as a large number of economic actors voluntarily engage in a wide range of privately provided economic activities. The bureaucracy, indirectly and sometimes reluctantly, encourages the private sector's development and expansion under reform socialism by simply removing or reducing the bureaucratic and legal constraints that hinder (or limit) private-sector activities (Kornai 1990; Stark and Nee 1988).

Participation in the emerging private sector under reform socialism is primarily motivated by material incentives and by the

desire to achieve greater levels of autonomy and economic independence from the state (Kornai 2008). Large sectors of the population that previously worked for the state make a rational, utility maximizing choice to join the emerging private sector, attracted by material incentives or the potential to earn higher incomes. As Kornai (1992) indicates, “For many people, private enterprise opens the road to prosperity” as a result of new opportunities to engage in private economic activities and create privately owned small-medium enterprises. The desire for greater autonomy also motivates participation in the emerging private sector under reform socialism. Contrary to classical socialism, under reform socialism, private entrepreneurs have complete control and disposal of residual income. Performance and income are directly linked under private ownership, which also motivates a segment of the population to join the emerging private sector (Kornai 2008).

Greater autonomy, however, does not come without risk, particularly given the high business failure rates that often take place as competition intensifies. But for entrepreneurial types, who value autonomy and independence from the state, the rewards of joining the emerging private sector far exceed the risks (Kornai 1992). Not everyone is willing to take on the risks, responsibility, uncertainty, and resulting stress associated with joining the private sector, however (Kornai 1992). Many remain content working for the state, particularly older workers and those lacking entrepreneurial spirit and the skills necessary to succeed in the highly competitive emerging private sector (Kornai 1992).

Kornai (1992) identified several types of private sector activities under reform socialism, most of which can be found in present-day Cuba. The first type is small-scale, family-operated, agricultural enterprises including direct producers and intermediaries. A principal element of Cuba’s effort to “update” its socialist economic model consists of Chinese-style agricultural reforms. China’s agricultural reforms began with the introduction of a “responsibility system” in which the state retained legal ownership of the land. Farming families became lessees who were directly responsible for the land’s productive results. Under the Chinese “responsibility system,” farming families, who previously worked for state-owned “communes,” were initially given short-term leases of the land (Selden 1988; Sicular 1985). The regulatory framework was later reformed, increasing tenancy duration and allowing land to be inherited and transferred (i.e., sold) (Selden 1988; Sicular 1985). In

the mid-1980s, regulations were further relaxed, turning family-operated plots, transferred from the former communes, into de facto private property. Even though some large-scale state-owned farms continued to operate, other farming assets such as livestock, machinery, equipment, and buildings were later privatized as agricultural reforms were expanded (Kornai 1992). In 1978, at the onset of the Chinese agricultural reforms, nearly 99 percent of the country's agricultural land was in state hands, and the state sector accounted for a similar share of agricultural output (Kornai 1992). A decade later, the state's share of the land and agricultural production had fallen to close to 40 percent (Kornai 1992).

Household farming and supplemental nonagricultural production are another type of private-sector activity that typically emerges under reform socialism (Kornai 1990). While household farming and supplemental agricultural production are permitted under the classical socialist model, these types of productive activities tend to expand significantly under reform socialism. Through the policy measures introduced under reform socialism, such as the expansion of agricultural credits, and by making machinery, equipment, transportation, and other essential inputs more available, the state incentivizes these types of private-sector activities (Kornai 1990).

Nonagricultural, small-scale, private-sector activities also expand significantly under reform socialism. Examples include services such as repair, maintenance, transportation of passengers and merchandise, construction, retail, and other professional and personal services. China also provides a useful illustration of this phenomenon. In 1981, there were an estimated 1,829,000 individually and/or family owned private firms in China, with some 2,274,000 employees (Kornai 1992). By 1988, the number of private firms had grown to 14,527,000, with some 23,049,000 employees (Kornai 1992). While official Cuban statistics do not provide a detailed breakdown of the self-employed and their firms, the data reveal a notable increase in the total number of self-employed workers since 2010 (see table 6), indicating that, similar to other countries that entered the reformed socialist stage, nonagricultural, small-scale, private-sector activities in Cuba have expanded significantly since the reforms.

Private, nonagricultural activities to supplement household income are also quite common under reform socialism. While these types of private activities also exist (or are tolerated) under the classical socialist model, they expand significantly under reform

socialism (Kornai 1992). These private activities primarily consist of extracurricular activities conducted by state employees for extra income, often using inputs or resources from their workplaces. As long as the buyers of the goods or services provided are other individuals or households, these activities can be classified as private-sector activities, even though they take place in state-owned workplaces (Kornai 1992).

The hiring of third-party labor by small-scale, privately owned firms becomes a legal practice and a common private-sector activity under reform socialism. Small-scale, privately owned enterprises are allowed to hire other (third-party) workers, who are also classified as self-employed (nonstate, private workers). The state plays a role in establishing basic labor laws, but wages and other aspects of compensation are set by the parties through legally binding contracts.

Legal arrangements that allow nonstate actors (e.g., cooperatives and self-employed workers) to lease state-owned property (typically in usufruct) are also common under reform socialism, as the state allows the creation of alternative spaces for the expansion of the nonstate sector. Under these arrangements, which did not exist under the classical socialist system, the state retains ownership of the property, which normally consists of depreciable fixed assets, but leases it to a private individual or group (i.e., a cooperative) for a predetermined period (Bársony 1982). The lessee (i.e., the individual or cooperative) has the right to retain any residual income (or profits) and is obligated to make up (or pay) any losses to the state (Bársony 1982). Under reform socialism, this type of arrangement is commonly used by service-oriented production units such as retail stores, restaurants, repair shops, barber and beauty shops, and small-scale professional services firms.

Joint-ownership firms provide an additional mechanism to facilitate the expansion of private-sector activities under reform socialism. This arrangement consists of a joint venture between the state and privately owned firms. In the case of Cuba, at the present time, joint ventures are only permitted between the Cuban state and foreign partners. Cubans residing abroad and those living on the island are not yet permitted to form joint ventures with state enterprises.

Finally, nonlabor, income-generating activities are also common under reform socialism. As Kornai (1992) indicates, this type of private-sector activity takes several forms: (a) holding an interest-bearing account at a state-run depository institution, (b) interest

income from debt securities issued by the state and/or state-owned enterprises, (c) interest income from loans to individuals (or small businesses), (d) partial (or fractional) ownership interests in privately owned enterprises, and (e) rental income from residential property, agricultural land, and/or renting automobiles, motorcycles, or any other forms of transportation to individuals or private businesses.

The introduction of reform measures to improve efficiency in selected state-owned enterprises (SOEs) is another important element of reform socialism (Balcerowicz 1989; Fischer and Gelb 1991; Kornai 1992). As Hinds (1991) indicates, state enterprise reforms under reform socialism are based on the theoretical assumption that “the enterprises’ objective is to maximize their workers’ income, which in turn is linked to profits based on market signals.” The most common state enterprise restructuring policies under reform socialism include increased autonomy by delinking enterprise ownership—which the state retains, and their management—which is transferred to the workers (Hinds 1991) and the introduction of a “hard budget constraint,” implying the introduction of a legal framework for bankruptcy, and regulations to address the unemployment resulting from enterprise restructuring (Kornai 1992; Lavigne 1989). These measures, however, do not represent a movement toward privatization (or the sale of SOEs to their employers, previous capitalist owners, or foreign investors), since the state retains ownership and control of all SOEs undergoing the process of “enterprise restructuring” that occurs under reform socialism. The state controls SOEs’ selection of administrative and managerial personnel, input procurement and prices, output distribution, labor relations, access to foreign exchange, international operations, prices, fiscal contribution, subsidies, investment, and access to credit financing (Hinds 1991). Despite their increased autonomy, state enterprises are vertically dependent on the state, since they are still considered collective or public property, and are horizontally dependent on their (mostly state-owned) suppliers as prescribed by the plan.

The modification of the price system is another important characteristic of reform socialism (Fischer and Gelb 1991; Kornai 1992). Price modifications (or price reforms) normally include changes in the methodology used by the state to set retail and wholesale prices, the application of new (i.e., market-oriented) principles to set the prices of the goods and services offered to the population, the gradual elimination of price rationing and subsidized

prices in some sectors of the economy, and tax reforms (Brus 1972; Kornai 1992). Price changes that can lead to rational prices drive economic efficiency and are needed to guide autonomous enterprises and to harden the budget constraint (Fischer and Gelb 1991). However, structural price changes can also result in major disruptions to state enterprises accustomed to benefiting from hidden subsidies, normally passed on through the price structure (Lardy 1990), drastically altering their relationships and interactions with the emerging private sector, the cooperative sector, and the state.

Reform socialism is also characterized by the implementation of “socialism without planning,” the predominance of the bureaucracy, and the coexistence of strong and weak forms of social organization (Kornai 2008). In the experience of the reform socialist countries,<sup>1</sup> the economic reform process was preceded by a series of formal (or official) “reform programs” designated to reform socialism from within (Burkett 1989; Hewett 1988; Kornai 2008). These economic reform programs, however, did not reflect the economic realities of these countries, and the departures from the original blueprints (for economic reforms) in these countries were so significant that the actual implementation of the proposed economic reform measures bore little if any resemblance to the original plans (Burkett 1989; Kornai 2008). As Kornai (2008) illustrates, paradoxically,

The reform process in socialist economies has conformed exactly to this: Whole societies have set out across the water without accurate knowledge of their final destination, by a process moving from one stone to another. Because of this lack of strategy, the reality of reform in socialist countries has been marked by historical compromise, by backward as well as forward movements, euphoria and optimism alternating with disillusionment and frustration. People often learn the limits of potential reform, so to speak, up against a stone wall. In any case, the limits of society’s ability to transform cannot be gauged accurately until the transforming process has begun.

The predominant role of the bureaucracy, and its permanence despite the implementation of economic reforms and the expansion of the private sector, is another important element of reform

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<sup>1</sup> According to Kornai (2008) the reform socialist countries, during various historical periods, are China, Hungary, Poland, the Soviet Union, and Yugoslavia.

socialism (Kornai 2008). According to Kornai (2008), this phenomenon persists under reform socialism because

the role of the bureaucracy remains paramount in selection and promotion of managers, and in decision-making power over the entry and exit of firms. While the bureaucracy relinquished direct administrative control over the quantities of output and input by state-owned firms, it can still control them by informal interventions, through formal state orders and informal requests, and through administrative price setting and extremely strong financial dependence of the firm on its superior organs. So, the state firm is strongly dependent on the various branches of the bureaucracy, the ministries in charge of production, foreign trade authorities, the price control office, financial bodies, the police, and so on. There is also frequent intervention in enterprise affairs by party organizations.

Ironically, under reform socialism, the bureaucratic apparatus may actually expand, despite concerted efforts to streamline or reduce it (Kornai 2008). There are two principal reasons for this. First, as in the classical socialist system, there are tangible and intangible advantages associated with the bureaucracy, such as financial benefits, privileges, and of course, power (Kornai 2008). Second, as the system is transformed, the bureaucratic apparatus is able to reinvent itself and adapt to the new political and economic environment (Kornai 2008).

Reform socialism is also characterized by the existence of strong and weak linkages between property (or ownership) forms and coordination mechanisms (Brus 1972; Stark and Nee 1988; Kornai 2008). Strong linkages between state-owned property (or state ownership of the means of production) and bureaucratic coordination mechanisms characterize the classical (prereform) socialist model (Kornai 1992, 2008). Under reform socialism, by contrast, even though the private (or nonstate) sector is primarily linked to market-based coordination mechanisms, it is also subject to bureaucratic control (Brus 1972; Stark and Nee 1988; Kornai 2008). In other words, despite the strong link between privately owned property forms and market coordination, a weak link between private property forms and bureaucratic coordination persists under reform socialism (Kornai 2008). However, as Kornai (2008) accurately points out, “The attempt to impose bureaucratic control on private activities does not and cannot work smoothly, due to the basic incongruity of

this mix” (i.e., the private sector and bureaucratic coordination). Similarly, attempts to apply market-based coordination to SOEs, in an effort to improve their efficiency and financial self-sustainability, are full of frictions, as bureaucratic coordination resurfaces and reduces the market’s influences (Kornai 2008). These frictions and contradictions are the result of the natural affinity and cohesion between certain types of ownership on property forms and certain types of coordination mechanisms (Stark 1990; Kornai 2008).

### **III. The Evolution of Private Self-Employment in Cuba since 2010**

The origins of Cuba’s recent economic reforms can be traced to Raúl Castro’s keynote speech on July 26, 2007. In a break with orthodox tradition, Cuba’s then-acting president recognized the need for profound structural and conceptual changes to address the principal challenges confronting the Cuban economy, such as insufficient physical output (particularly in agriculture), growing inflation, low salaries and pensions, excessive regulations and prohibitions, low productivity levels, widespread pilfering of workplace resources, and a severely deteriorated infrastructure and productive base after years of massive decapitalization (Mesa-Lago and Pérez-López 2013; Spadoni 2014). Starting in 2008, the Cuban government began to implement a series of economic transformations to update the country’s socialist economic model. The main goals of these reforms include the following (Mesa-Lago and Pérez-López 2013; Spadoni 2014):

- increasing the country’s productive base
- improving the efficiency of SOEs
- improving agricultural production
- reducing state subsidies to money-losing SOEs
- gradually phasing out and eventually eliminating the rationing system instituted since 1961
- eliminating monetary dualism
- lifting excessive and unnecessary restrictions and regulations
- promoting the expansion of small-scale private enterprises and self-employment as an alternative to employment in the state sector

The principal structural and administrative reforms implemented in Cuba since 2008 include the following (Mesa-Lago and Pérez-López 2013; Spadoni 2014):

- transfers of nonproductive state-owned lands to nonstate producers (e.g., cooperatives and individual farmers)
- the decentralization and reorganization of the Ministry of Agriculture
- the reduction of state-sector payrolls through policies to promote the expansion of self-employment and cooperative-sector employment
- the legalization of private automobile and home sales (although restrictions to prevent the concentration of wealth remain in place)
- restructuring wholesale activities in agriculture
- a progressive (but still onerous) tax system
- immigration reforms (allowing regular Cubans to travel abroad)
- a new social security law
- the reorganization of the state administrative apparatus

Some of the proposed, but still pending, reforms include the elimination of the rationing system instituted in 1961, the unification of the two currencies that currently circulate in Cuba (i.e., the Cuban peso, or CUP, and the convertible peso, or CUC), and the creation of wholesale markets where nonstate producers (e.g., cooperatives, small-scale private enterprises, and self-employed workers) can legally obtain essential inputs at market prices in Cuban pesos.

Cuba's economic reforms were accelerated after the approval of the *Lineamientos de la Política Económica y Social del Partido y la Revolución* (or Economic and Social Guidelines) during the Sixth Party Congress of the Communist Party of Cuba in April 2011. The guidelines called for significant structural and conceptual changes to Cuba's centralized economic model while preserving its socialist character. The most notable changes or transformations outlined in the guidelines include the following (Mesa-Lago and Pérez-López 2013; Spadoni 2014):

- increased administrative and managerial autonomy for SOEs
- the creation or promotion of nonagricultural cooperatives for production, services, and commercialization
- continued transfers of idle state lands to nonstate producers (in usufruct)
- the creation of wholesale input markets for state and nonstate producers (still pending)

- the establishment of special development zones to attract foreign direct investment in strategic areas such as tourism, mining, and light manufacturing
- the legalization of private automobile and home sales, gradually phasing out (and eventually eliminating) the rationing system established in 1961 (still pending)
- ending monetary dualism (still pending)

As a consequence of these reform measures, Cuba's private sector has expanded significantly in recent years.

The data for monetary circulation, in particular, suggest an increase in monetary overhang (or excess liquidity), which is commonly associated with private-sector expansion in socialist economies (Mesa-Lago and Pérez-López 2013; Spadoni 2014). As table 1 illustrates, currency in circulation increased from 16.9 percent of gross domestic product (GDP) in 2009 to 21.3 percent in 2014. Due to Cuba's dual currency system, the M1 monetary aggregates shown in table 1 are reported in "regular" Cuban pesos (CUP) and in convertible pesos (CUC). The "regular" Cuban peso is normally used in the state sector, while convertible pesos typically function as a unit of account, medium of exchange, and store of value in the "hard currency sector," which includes state-run retail shops and outlets, tourism establishments, many restaurants, gas stations, and other outlets in the retail chain. Convertible pesos are also used to conduct wholesale intraenterprise trade for a selected group of state enterprises and transactions in "economic associations" (i.e., joint ventures with foreign investors). The official CUP/CUC exchange rate is 24 CUP per CUC, and many of the country's emerging privately owned small and medium enterprises (SMEs) and self-employed workers transact in both currencies. State-sector wages, pensions, and social security (disability) payments are paid in "regular" pesos, while salaries and bonuses in "mixed enterprises" (or joint ventures between state enterprises and foreign investors) are normally paid in convertible pesos (Mesa-Lago and Pérez-López 2014; Spadoni 2014). Self-employed workers, including those employed by privately owned SMEs, can be paid in either currency, which can be exchanged in state-run foreign exchange houses (CADECA, short for Casas de Cambio) or in the informal market (Spadoni 2014).

**Table 1. Cuba: Selected Economic Indicators**

	2009	2010	2011	2012	2013	2014
<b>Gross domestic product (GDP)</b>						
	<b>Annual growth rates</b>					
GDP at constant prices	1.4%	2.4%	2.8%	3.0%	2.7%	1.0%
GDP per capita at constant prices	1.4%	2.4%	2.8%	3.7%	2.5%	0.8%
GDP deflator (1997=100)	33.9	35.5	41.4	45.5	49.4	54.6
<b>External sector</b>						
Exchange rate, USD per convertible peso (CUC)	1.8	1.1	1.0	1.0	1.0	1.0
Exchange rate (CADECA), Cuban pesos (CUP) per CUC	24.0	24.0	24.0	24.0	24.0	24.0
<b>Balance of payments</b>						
	<b>Millions of pesos (CUP) at constant prices</b>					
Current account	-162	1,491	1,437	2,382	—	—
Balance of goods and services	1,246	3,119	2,240	3,771	—	—
	<b>% of GDP</b>					
Current account	-0.3	2.3	2.1	3.3	—	—
Balance of goods and services	2.0	4.8	3.2	5.2	—	—
External debt (total)	19.8	21.1	20.2	17.1	—	—
<b>State revenues and expenditures</b>						
	<b>% of GDP</b>					
Total revenues	70.7	66.4	65.0	66.5	60.1	59.3
Total expenditures	75.6	70.0	66.7	70.1	64.6	61.9
Fiscal balance	-4.9	-3.6	-1.7	-3.7	-1.3	-2.3
<b>Monetary circulation</b>						
Currency in circulation	16.9	16.1	15.4	17.1	17.8	21.3
M1A (CUP)	25.6	24.0	22.7	25.0	26.2	31.6
M12A (CUC)	41.3	40.6	39.3	41.1	41.7	49.2
<b>Consumer Price Index (CPI)</b>						
CPI, CUP	-0.1	1.6	3.6	2.0	0.6	2.1
<b>Unemployment rate</b>						
Unemployment rate (%)	1.7	2.5	3.2	3.5	3.3	2.7

*Source:* ONEI 2015.

As table 1 shows, the M1 monetary aggregate in “regular” Cuban pesos increased from 25.6 percent of GDP in 2009 to 31.6 percent in 2014; similarly, the M1 monetary aggregate in convertible pesos grew from 41.3 percent of GDP to 49.2 percent during the same period. In a socialist economy such as Cuba’s, monetary overhang (or excess liquidity) is caused when households and enterprises are unable to increase their monetary holdings, a phenomenon primarily driven by the excess supply of money caused by recurrent budget deficits

(Rautava 1993). In reformed socialist economies where centralized planning remains as the principal economic coordination mechanism and a fixed-price system is used in principal sectors, as in the case of Cuba, excess demand cannot be eliminated by price increases (Mesa-Lago 2012). Real consumption is constrained by insufficient supply due to the lack of price incentives and the predominance of centralized planning; as a result, unmet excess demand takes the form of increased forced savings among households and enterprises (Rautava 1993). In the case of Cuba, (forced) household savings increased 45.6 percent, from CUP 15.2 billion in 2009 to CUP 22.1 billion in 2014 (ONEI 2015).

Table 2 presents Cuba's GDP by economic activity during the 2009–14 period. The principal activities in which self-employed workers and privately owned SMEs normally participate are agriculture, construction, transportation, commerce, and hotels and restaurants. Official figures do not differentiate the figures reported for these economic activities by sector (i.e., state sector vs. nonstate sector); therefore, estimating the value of the output produced by the private sector in these activities is virtually impossible.

Nonetheless, as table 2, shows, from 2009 through 2014, the value of the output produced in the top five economic activities in Cuba's private sector represents an important share of the total. Increases occurred as follows:

- agriculture: 7.2 percent
- construction: 0.7 percent
- transportation: 21.5 percent
- commerce: 21.3 percent
- hotels and restaurants: 29.7 percent

In 2014, their combined share reached close to half of GDP (44.2 percent), in part driven by the private sector's expansion since 2009–10.

**Table 2. Cuba: Gross Domestic Product by Economic Activity, Constant 1997 Prices, Millions of Pesos (CUP)**

	2009	2010	2011	2012	2013	2014
GDP	46,353	47,461	48,791	50,262	51,643	52,184
Agriculture	1,815	1,722	1,807	1,817	1,902	1,945
Fishing	79	60	52	55	58	59
Mining	278	298	303	309	302	300
Sugar	222	193	203	218	235	245
Manufacturing (excluding sugar )	6,195	6,294	6,540	6,673	6,798	6,534
Construction	2,864	2,651	2,458	2,734	2,951	2,883
Electricity and water	662	651	669	698	724	729
Transportation, warehousing, and communications	4,118	4,224	4,377	4,648	4,796	5,002
Commerce	8,374	8,537	9,004	9,485	9,837	10,158
Hotels and restaurants	2,385	2,559	2,790	2,932	3,001	3,094
Financial intermediation	1,244	1,251	1,266	1,272	1,287	1,339
Enterprise services, real estate activities	1,342	1,424	1,473	1,684	1,727	1,815
Public administration, national defense, social security	1,888	1,921	1,950	1,949	1,972	1,961
Science, innovation, and technology	203	218	235	252	262	262
Education	3,731	3,899	3,692	3,552	3,475	3,370
Public health and public assistance	7,984	8,432	8,721	8,756	8,917	9,095
Culture and sports	1,799	1,939	1,904	1,900	1,990	2,038
Other activities, communal services, personal associations	727	726	738	732	764	780
Import rights	443	462	609	596	645	575

*Source:* ONEI 2015.

The private sector's increased share of final household consumption is another indicator of its growing importance in the Cuban economy. As table 3 demonstrates, the value of final household consumption supplied by the self-employed workers market, which includes self-employed workers and privately owned SMEs, increased by 83.2 percent, from CUP 1.181 billion in 2009 to CUP 2.164 billion in 2014. In 2009, the self-employed workers market provided 5.1 percent of final household consumption; this figure increased to 7.5 percent in 2014. Agricultural markets, which include private producers, cooperatives, state-owned agricultural

enterprises, the self-employed workers market, and other sources (including informal markets, employer-based self-consumption units (e.g., workplace plots), and social consumption units (e.g., subsidized workplace cafeterias, schools, and social assistance centers) supplied 19.6 percent of final consumption, with the remaining 80.4 percent supplied by the state sector. This figure increased to 24.5 percent, driven (in part) by the rapid expansion of self-employment and privately owned SMEs.

**Table 3. Cuba: Final Household Consumption by Sources, Millions of Pesos (CUP)**

	2009	2010	2011	2012	2013	2014
<b>Household consumption (at current prices)</b>	<b>29,858</b>	<b>32,369</b>	<b>36,469</b>	<b>39,755</b>	<b>41,878</b>	<b>44,432</b>
State sector	23,845	25,534	28,958	31,300	32,062	33,159
Agriculture	1,710	2,006	1,956	1,823	2,455	2,865
Self-employed workers	1,635	2,126	2,711	3,394	4,078	4,680
Other sources	2,668	2,703	2,844	3,238	3,283	3,728
<b>Household consumption (at 1997 constant prices)</b>	<b>23,236</b>	<b>25,151</b>	<b>25,412</b>	<b>26,239</b>	<b>27,593</b>	<b>28,858</b>
State sector market	18,673	19,990	20,019	20,648	21,104	21,790
Agricultural markets	1,721	1,977	2,184	2,321	2,949	3,223
Self-employed workers	1,181	1,494	1,663	1,701	1,952	2,164
Other sources	1,661	1,690	1,546	1,569	1,588	1,681
	<b>Annual growth rate (%)</b>					
<b>Household consumption (at 1997 constant prices)</b>	<b>0.9</b>	<b>7.9</b>	<b>1.4</b>	<b>3.3</b>	<b>5.2</b>	<b>4.6</b>
State sector	0.5	66	0.6	3.1	2.2	3.3
Agriculture	10.9	14.9	10.5	6.3	27.1	9.3
Self-employed workers	7.8	26.5	11.3	2.3	14.8	10.9
Other sources	-7.9	1.7	-8.5	1.5	1.2	5.9

*Source:* ONEI 2015.

Tax receipts, particularly in the categories associated with self-employed workers and private SMEs (e.g. sales taxes, income taxes, and taxes on profits or rents) have increased notably in recent years, in direct correlation with the private sector's expansion.

**Table 4. Cuba: State Budget Revenues, Millions of Pesos (CUP)**

	2009	2010	2011	2012	2013	2014
<b>Gross receipts</b>	<b>44,186</b>	<b>42,975</b>	<b>45,249</b>	<b>49,032</b>	<b>46,971</b>	<b>47,269</b>
<b>Tax receipts</b>	<b>25,494</b>	<b>24,201</b>	<b>26,508</b>	<b>29,068</b>	<b>28,805</b>	<b>30,236</b>
Sales taxes	12,768	10,525	11,819	14,511	14,057	14,171
Taxes on services	1,564	1,758	1,876	1,721	1,531	1,740
Taxes on profits (or rents)	2,711	3,049	3,742	3,662	4,237	4,687
Taxes on Labor	4,246	4,414	4,235	4,108	3,424	2,939
Personal income taxes	480	554	762	873	1,055	1,308
Social security taxes	2,774	2,974	2,996	3,043	3,123	3,622
Other taxes and rights	951	927	1,078	1,150	1,378	1,769
<b>Nontax receipts</b>	<b>18,692</b>	<b>18,774</b>	<b>18,741</b>	<b>19,964</b>	<b>18,166</b>	<b>17,033</b>
Contributions by state enterprises	3,115	3,380	4,664	5,629	5,322	5,206
Other nontax receipts	15,577	15,394	14,077	14,335	12,844	11,827

*Source:* ONEI 2015.

As table 4 indicates, from 2009 through 2014, state revenues from sales taxes increased by 11 percent, from CUP 12.768 billion to CUP 14.171 billion; receipts from taxes on profits or rents increased 72.9 percent, from CUP 2.711 billion to CUP 4.687 billion; and revenues from personal income taxes rose 172.5 percent, from CUP 480 million to CUP 1.308 billion. In 2009, state budget revenues from sales taxes represented 28.9 percent of total gross tax receipts, which includes revenues from taxes and nontax revenues, compared to 30 percent in 2014. Similarly, taxes on profits or rents represented 6.1 percent of gross receipts in 2009, compared to 9.9 percent in 2014. While income taxes only accounted for 1.1 percent of gross tax receipts in 2009, their share increased to 2.8 percent in 2014.

With regards to total tax receipts reported on the state budget, it is worth noting that in 2009, sales taxes represented 50.1 percent of the total; this figure declined to 46.9 percent in 2014. By contrast, taxes on profits or rents represented 10.6 percent of total state budget tax receipts in 2009, compared to 15.5 percent in 2014; and personal income taxes accounted for 1.9 percent of total tax receipts, compared to 4.3 percent during the same period (table 4).

The private sector's share of newly constructed residential housing units has increased significantly since 2011. Prior to the introduction of Decree-Law 288 in 2011, which legalized home sales and allows ordinary Cubans to own a second (vacation) home, Cuba's housing policies were in some regards similar to the policies of

Central and Eastern European (CEE) countries during the classical socialist period. Until 2011, with some slight variations, the state sector dominated the allocation and consumption of housing, while the market was restricted and kept subordinate (Mandić 2010). Housing was primarily considered a universal, social right intended to satisfy the population's needs, rather than a commodity (Mandić 2010). Unlike the Soviet Union and the CEE countries, Cuba's housing policies since 1959 prioritized homeownership, rather than public rented housing. However, similar to other socialist countries, its housing sector was (and still remains to a great extent) characterized by permanent shortages, long waiting periods, limited availability of construction and repair materials, and unequal access favoring the nomenklatura (Szelenyi 1983; Mandić 2010).

While an estimated 85 percent of Cubans own their homes, the country faces a severe housing shortage, ranging from 500,000 to 1,000,000 units, and more than 50 percent of the existing residential stock is in poor condition, primarily due to insufficient access to capital and material resources to maintain the housing stock (Díaz-Briquets 2014; Grein 2015; Mesa-Lago and Pérez-López 2013). Some estimates suggest that Cuba needs to build between 60,000 and 70,000 new housing units annually to alleviate its severe housing shortage (Peters 2014). To address the shortage, the Cuban government announced plans to support new home construction by private households in 2013, including the expansion of home construction and repair lending programs offered by the state-run Banco Popular de Ahorro (BPA) and the opening of forty-three construction supply centers in Havana and 1,100 similar outlets in the rest of the country (Peters 2014).

As table 5 demonstrates, even though new residential construction volumes remain well below the amounts needed to alleviate Cuba's housing shortage—and declined by 23.1 percent, from 32,540 units in 2011 to 25,037 units in 2014—new housing construction by private households has increased significantly since 2011. From 2011 through 2014, the number of residential units completed by private households increased 42.1 percent (from 8,933 to 12,699). In 2011, new housing units built by private households (8,933) represented 27.5 percent of the total (32,540), compared to, 50.7 percent (12,699 out of 25,307) in 2014. In 2011, privately constructed residential units accounted for 93.3 percent of the total in the nonstate sector, which also includes cooperatives. This figure increased to 98.9 percent in 2014.

**Table 5. Cuba: Completed Residential Units by Sector**

Year	Total (state and nonstate sectors)	State sector	Total (nonstate sector only)	Nonstate sector			Private households
				UBPC	CPA	CCS	
2009	35,085	19,437	15,648	560	681	227	14,180
2010	33,901	21,687	12,214	216	311	254	11,433
2011	32,540	22,966	9,574	255	166	220	8,933
2012	32,103	22,343	9,760	143	208	145	9,264
2013	25,634	12,868	12,766	314	124	111	12,217
2014	25,037	12,197	12,840	68	46	27	12,699

*Note:* UBPC stands for Unidades Básicas de Producción Cooperativa (or Basic Production Cooperative Units). CPA stands for Cooperativas de Producción Agropecuaria (Cooperatives of Agricultural Production). CCS stands for Cooperativas de Créditos y Servicios (Credit and Services Cooperatives).

*Source:* ONEI 2015.

By contrast, the number of residential units completed by the state sector declined by 46.9 percent over the same period, from 22,966 in 2011 to 12,197 in 2014. In 2011, the state sector accounted for 70.6 percent of all newly constructed housing units, compared to 48.7 percent in 2014. The data in table 5 demonstrate that the decline in the state sector's share of new housing construction has been countered by the private sector's rapid (albeit insufficient) expansion in this important area of the Cuban economy.

The expansion of self-employment is a principal pillar of Cuba's recent efforts to update its socialist economy. The economic reforms introduced in 2010 and 2011 have contributed to significant increases in self-employment and private SMEs in Cuba. In October 2010, self-employment in 178 activities or categories was legalized, representing a notable increase from the previous limits. Self-employed workers in eighty-three of these categories are essentially permitted to function as microentrepreneurs by being allowed, for the first time since the Revolutionary Offensive of 1968, to hire other self-employed workers (Spadoni 2014). The approval of Decree-Law 268 (2010) allowed self-employed workers to obtain licenses to simultaneously engage in various types of self-employment activities, in essence paving the way for the proliferation of serial microentrepreneurs and the expansion of private SMEs in Cuba. The approval of Decree-Law 289 in December 2011 created a new system of microcredits to help self-employed workers and private SMEs obtain small amounts of

credit financing from state-owned banks to finance new business creation or obtain working capital for existing businesses (Mesa-Lago and Pérez-López 2013). The approval of Resolution 42 by the Ministry of Labor and Social Security in September 2013 increased the total number of authorized self-employment categories or activities to 201, and added new categories such as real estate agents, agricultural wholesalers, cellular repairmen, and builders (Spadoni 2014). Self-employed workers are also allowed to sell goods and services to the state and to the cooperative sector, and to rent their place of business directly from other individuals, or in some cases from nonagricultural cooperatives that can lease retail spaces from the state (in usufruct).

Cuba's recent policies to promote self-employment also include a new tax code. The new tax system, instituted after the approval of Resolution 298 in 2011, established three types of taxes for self-employed workers (or microentrepreneurs): (1) a progressive income tax (ranging from 15 percent to 50 percent of annual income) where taxes are paid in regular Cuban pesos, regardless of the currency in which business is conducted; (2) a simplified tax system consisting of fixed monthly payments, if no third-party self-employed workers are hired; (3) a 25 percent payroll tax on employee wages and a 10 percent sales tax, which includes a business expense allowance of up to 40 percent. To qualify for a pension upon retirement, self-employed workers are also required to contribute 25 percent of their income to the national social security system (Spadoni 2014).

As table 6 indicates, in 2010, a total of 4,178,100 workers were employed in the state sector; this figure declined by 13.2 percent (or 550,500 workers) to 3,627,600 workers in 2013. By contrast, employment in the nonstate sector, which includes cooperatives, joint ventures between state enterprises and foreign entities, and self-employed workers grew by 60.1 percent, from 806,400 workers in 2010 to 1,217,900 in 2013. Within the nonstate sector, employment in cooperatives only grew by 4.6 percent during the 2010–13 period, despite official efforts to promote cooperatives as a “superior” and “more socialized” property form through the approval of nonagricultural cooperatives in December 2012. This slow growth contrasted with the growth of total private-sector self-employment during the same period. As table 6 illustrates, the number of self-employed workers in Cuba grew by 187.9 percent, from 147,400 in 2010 to 424,300 in 2013.

**Table 6. Cuba: Employment in the State and Nonstate Sectors, 2010–13**

	2010	2011	2012	2013	Change	% Change
<b>Total</b>	<b>4,984,500</b>	<b>5,010,200</b>	<b>4,902,200</b>	<b>4,918,800</b>	<b>-65,700</b>	<b>-1.3%</b>
Female	1,900,300	1,876,400	1,802,600	1,838,600	-61,700	-3.2%
Male	3,084,200	3,133,800	3,099,600	3,080,200	-4,000	-0.1%
<b>State sector</b>	<b>4,178,100</b>	<b>3,873,000</b>	<b>3,684,300</b>	<b>3,627,600</b>	<b>-550,500</b>	<b>-13.2%</b>
Female	1,787,000	1,669,300	1,634,100	1,631,900	-155,100	-8.7%
Male	2,391,100	2,203,700	2,050,200	1,995,700	-395,400	-16.5%
<b>Nonstate sector</b>	<b>806,400</b>	<b>1,137,200</b>	<b>1,217,900</b>	<b>1,291,200</b>	<b>484,800</b>	<b>60.1%</b>
Female	113,300	207,100	168,500	206,700	93,400	82.4%
Male	693,100	930,100	1,049,400	1,084,500	391,400	56.5%
<b>Cooperatives</b>	<b>217,000</b>	<b>208,700</b>	<b>212,600</b>	<b>227,000</b>	<b>10,000</b>	<b>4.6%</b>
Female	35,800	30,800	29,800	31,200	-4,600	-12.8%
Male	181,200	177,900	182,800	195,800	14,600	8.1%
<b>Private sector</b>	<b>589,400</b>	<b>928,500</b>	<b>1,005,300</b>	<b>1,064,200</b>	<b>474,800</b>	<b>80.6%</b>
Female	77,500	176,300	138,700	175,500	98,000	126.5%
Male	511,900	752,200	866,600	888,700	376,800	73.6%
<b>Self-employed workers</b>	<b>147,400</b>	<b>391,500</b>	<b>404,600</b>	<b>424,300</b>	<b>276,900</b>	<b>187.9%</b>
Female	29,500	61,900	63,000	73,300	43,800	148.5%
Male	117,900	329,600	341,600	351,000	233,100	197.7%

Source: ONEI 2014; authors' calculations.

The state sector employed 83.8 percent of all active workers in 2010; this figure decreased to 73.7 percent in 2013. In 2010, 16.2 percent of all active workers were employed in the nonstate sector, compared to 26.3 percent in 2013. The share of active workers employed in cooperatives remained virtually unchanged, at less than 5 percent, during the 2010–13 period, reflecting the relative decline of this property form in terms of its share of total employment (see table 6). Self-employed workers represented 3 percent of total employment in 2010; this ratio more than doubled, reaching 8.6 percent in 2013. Cuba's self-employed workers represented 18.3 percent of all nonstate sector workers in 2010; by 2013, this figure had increased to 32.9 percent. Self-employed workers represented 25 percent of all private-sector workers in 2010, and 40 percent in 2013 (table 6).

Private-sector expansion has been particularly notable in nonsugar agriculture.<sup>2</sup> Since 2007, the Cuban government has implemented a series of agricultural reforms to increase output and reduce the country's dependence on imported food and agricultural products. The most important reforms include moderate price reforms, the decentralization of decision making, limited liberalization of agricultural commercialization, and most significantly, the transfer of idle state-owned land to cooperatives and private farmers in usufruct (Nova González 2013). Even though Cuba's agricultural sector still operates under some forms of triangular intervention described by Rothbard (1970 [2006]), such as price controls and product prohibitions, the reform measures introduced since 2007 have contributed to notable increases in the private sector's share in Cuba's nonsugar agriculture. These increases can be measured in terms of the private sector's share of total employment, land distribution, area planted, and physical output.

The lack of detailed private-sector employment in Cuba's agricultural sector limits the ability to analyze its recent evolution. Official employment statistics indicate that there were 921,500 workers employed in the agricultural sector in 2010, representing 18.5 percent of total employment. By the end of 2013, the number of total agricultural workers had increased by 1.9 percent to 939,100, representing 19 percent of total employment (ONEI 2014). However, these figures do not differentiate state workers from nonstate workers. Cuba's official employment statistics report employment in the nonstate sector as an aggregate figure instead of providing a detailed institutional breakdown of employment data.

However, a recent study by Ritter (2016) estimates that there were some 220,000 small-scale, independent farmers in Cuba at the end of 2014. In addition, an estimated 353,000 workers were employed in the relatively autonomous Cooperativas de Créditos y Servicios (Credit and Services Cooperatives, or CCS), which are

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<sup>2</sup> Cuba's National Statistics Office (ONEI) does not provide detailed land tenure, output, and yield data for private agricultural producers, which include independent farmers, "dispersed farmers," and "*usufructuarios*" (i.e., individual farmers and their families who lease idle state-owned lands in usufruct—or ten-year renewable leases—under the provisions of Decree-Law 259 (2008) and Decree-Law 300 (2012). Instead, aggregate data is presented under the nonstate sector category, which also includes figures on the Basic Units of Cooperative Production (*Unidades Básicas de Producción Cooperativa*, UBPC), Cooperatives of Agricultural Production (*Cooperativas de Producción Agropecuaria*, CPA), and Credit and Services Cooperatives (*Cooperativas de Créditos y Servicios*, CCS).

officially classified as part of the private sector (Ritter 2016).<sup>3</sup> Based on Ritter's (2016) estimates, privately employed agricultural workers (573,000) represent 36 percent of Cuba's total private-sector workers (1,573,000), which include registered self-employed workers, unregistered self-employed workers and SMEs, employees in joint ventures between SOEs and foreign investors, and registered and unregistered self-employed workers in religious activities, arts, and crafts (Ritter 2016).

In 2013, Cuba's arable land (or total agricultural surface) (6.3 million hectares [ha]), represented 57.7 percent of the country's total land (10.9 million ha) (ONEI 2014). Approximately 41.7 percent of the arable land was harvested (or under cultivation) in 2013. While the state sector holds 54 percent of Cuba's total land (5.9 million ha), only 29.2 percent of arable land is held by the state (1.9 million ha), out of which 25.4 percent (472,000 ha) was harvested or under cultivation at the end of 2013. The nonstate sector and private farmers (*privados*) have seen their share of total land, arable land (or agricultural surface), and land under cultivation increase significantly since 2008 (see table 7). At the end of 2013, the nonstate sector held 46 percent of Cuba's total land (5 million ha) and 70.8 percent of the country's arable land (4.5 million ha). Close to half (48.4 percent) of the arable land (2.2 million ha) held by the nonstate sector was harvested (or under cultivation), representing 84.6 percent of the country's area under cultivation (2.6 million ha)

Table 7 shows the areas planted and under production for selected nonsugar crops held by Cuba's nonstate agricultural producers during the 2008–13 period. The area planted and under production held by the nonstate sector increased in six of the nine principal nonsugar crop categories reported by the National Statistics Office during the 2008–13 period. The main crops in which the area planted held by the private sector grew the most during this period were cereals, which includes corn and rice (32.1 percent); roots and tubers (25.7 percent); legumes (beans) (25.2 percent); cocoa (15.8 percent); and *viandas* (15.3 percent). The nonstate sector's growing share of the area planted dedicated to nonsugar agricultural production during the 2008–13 period is also illustrated when measured as a ratio of the total area planted and under production. For example, in 2013, the nonstate sector held 93.6 percent of the

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<sup>3</sup> These figures are not included in the data presented in table 6, which only refers to the number of registered self-employed workers.

area planted dedicated to *viandas*, a category that includes essential staples for the basic Cuban diet, compared to 86.3 percent in 2008. The area planted and under production held by the nonstate sector also increased in the case of roots and tubers (from 87.8 percent to 94.5 percent), other fruits (from 85.6 percent to 93.9 percent), and cocoa (from 91.9 percent to 96.3 percent).

**Table 7. Cuba: Nonstate Sector: Area Planted and under Production (Hectares), Selected Nonsugar Crops**

Crop	2008	2009	2010	2011	2012	2013	Ha change	% change
Viandas	241,400	317,894	331,911	269,044	249,318	278,252	<b>36,852</b>	<b>15.3%</b>
Roots and tubers	172,238	223,416	223 743	186,076	178,519	216,507	<b>44,269</b>	<b>25.7%</b>
Plantains	69,162	94,478	108,168	82,968	70,799	61,745	<b>-7,417</b>	<b>-10.7%</b>
Cereals	254,745	383,803	374,554	299,798	330,770	336,513	<b>81,768</b>	<b>32.1%</b>
Rice	136,906	188,904	157 114	163,299	184,010	165,406	<b>28,500</b>	<b>20.8%</b>
Corn	117,839	194,899	217 440	136,499	146,760	171,108	<b>53,269</b>	<b>45.2%</b>
Legumes (Beans)	90,448	144,939	106,349	116,832	117,674	113,266	<b>22,819</b>	<b>25.2%</b>
Tobacco	22,739	24,278	19 961	13,120	15,629	12,551	<b>-10,188</b>	<b>-44.8%</b>
Citrus Fruits	24,643	29,785	27 214	18,237	12,998	8,456	<b>-16,187</b>	<b>-65.7%</b>
Other Fruits	71,114	80,744	85 539	71,133	71,833	74,569	<b>3,455</b>	<b>4.9%</b>
Cocoa	3,494	4,744	4 800	4,827	3,998	4,047	<b>553</b>	<b>15.8%</b>

Source: ONEI 2014; authors' calculations.

Table 8 shows nonstate sector production of selected nonsugar crops from 2008 through 2013.

Physical output by the nonstate sector also increased in six of the nine main nonsugar crop categories reported by the National Statistics Office during the 2008–13 period. These were: *viandas* (12.1 percent), roots and tubers (22.6 percent), cereals (42 percent), legumes (32.2 percent), other fruits (22.9 percent), and cocoa (35.1 percent). Even though the nonstate sector already accounted for the majority of output in these crop categories in 2008, its share of total production continued to grow during the 2008–13 period. Nonstate production as a ratio of total output increased in the following crop categories during this period: *viandas* (from 85.2 percent to 91.8 percent), roots and tubers (from 86.6 percent to 95.5 percent), and cocoa (from 94.5 percent to 98.6 percent).

**Table 8. Cuba: Nonstate Sector, Agricultural Production, Selected Nonsugar Crops (Tons)**

Crop	2008	2009	2010	2011	2012	2013	Tons change	% change
<i>Viandas</i>	1,832,349	1,915,023	1,986,811	2,061,340	2,129,158	2,054,379	<b>222,030</b>	<b>12.1%</b>
Roots and tubers	1,205,406	1,348,447	1,350,001	1,321,141	1,342,252	1,477,836	<b>272,430</b>	<b>22.6%</b>
Plantains	626,943	566,576	636,810	740,199	786,906	576,543	<b>-50,401</b>	<b>-8.0%</b>
Cereals	685,441	763,357	713,150	831,144	939,240	973,038	<b>287,597</b>	<b>42.0%</b>
Rice	381,344	483,693	402,211	489 897	588 913	562,380	<b>181,036</b>	<b>47.5%</b>
Corn	304,097	279,663	310,939	341 247	350 327	410,658	<b>106,561</b>	<b>35.0%</b>
Legumes (Beans)	94,265	104,671	76,802	128,515	122,665	124,593	<b>30,328</b>	<b>32.2%</b>
Tobacco	21,250	24,934	20,273	19 680	19,284	23,847	<b>2,597</b>	<b>12.2%</b>
Citrus Fruits	148,400	162,107	148,116	105 777	78,782	55,290	<b>-93,110</b>	<b>-62.7%</b>
Other Fruits	680,933	678,825	719,098	768 240	916,299	855,518	<b>174,585</b>	<b>25.6%</b>
Cocoa	1,040	1,331	1,639	1 448	1,991	1,405	<b>365</b>	<b>35.1%</b>

*Source:* ONEI 2014; authors' calculations.

#### IV. Future Prospects

As part of its efforts to update its socialist economy, Cuba has implemented a series of policy measures to facilitate the expansion of private-sector self-employment since 2010. Although the Cuban experience and context with regard to economic reforms is unique in many aspects, the experiences of other transition economies offer valuable lessons for Cuba, particularly when it comes to the promotion of self-employment and small-scale private enterprises.

Privately owned SMEs are an important source of job creation and offer significant innovative potential (Aidis 2005; Johnson and Loveman 1995; McMillan and Woodruff 2002). The distortions and inefficiencies created by communist centrally planned economies lead to the reduction of employment in the state sector during the transition period, which is countered by increases in private-sector employment (McMillan and Woodruff 2002). New privately owned firms represented the fastest-growing sector in the post-socialist economies of Central and Eastern Europe, particularly during the early years of the transition (McMillan and Woodruff 2002). According to Belka et al. (1995) and Johnson, McMillan, and Woodruff (2000), newly formed private firms in Poland and Russia grew and invested at a faster rate and experienced faster job growth than privatized (formerly state-owned) firms. While employment in the state sector continued to decline, Vietnam's private sector

generated an estimated 10 million jobs during the first seven years after the 1986 economic reforms began (McMillan and Woodruff 2002).

Other postsocialist countries had similar experiences. Privately owned start-ups accounted for almost all the new jobs created in Estonia from 1989 through 1994 (Haltiwanger and Vodopivec 2000). In Poland, 86 percent of newly formed private enterprises created jobs during the 1994–96 period (McMillan and Woodruff 2002). In Bulgaria and Romania, even though newly formed private firms accounted for just 3 percent of total employment from 1990 through 1996, they created more than 50 percent of all new jobs (McMillan and Woodruff 2002). In addition to jobs, newly created private enterprises provide other benefits during the post-socialist transition. Compared to state-owned enterprises and recently privatized state firms, they are more dynamic and more able to adapt to a rapidly changing, competitive environment (Haltiwanger and Vodopivec 2000; McMillan and Woodruff 2002). Finally, newly created private firms also provide “competitive discipline” for existing firms (McMillan and Woodruff 2002); the increased competitive pressure resulting from the high levels of entry of newly formed private enterprises forces existing firms to improve their performance and efficiency and contributes to improvements in total factor productivity and overall economic efficiency (McMillan and Woodruff 2002).

Private enterprises in transition economies are usually required to contend with state interference, which is manifested through a series of institutional barriers. Formal institutional barriers primarily consist of an onerous tax system, excessive prohibitions, and a cumbersome, complex, and often rigid regulatory framework (Bohata and Mladek 1999; Brunetti, Kisunko, and Weder 1998; Hashi 2001). Entrepreneurial activities are also affected by environmental barriers such as primitive financial institutions, limited (or nonexistent) financing mechanisms, relatively low purchasing power (Pissarides, Singer, and Svejnar 2000; Hashi 2001), payments in arrears by clients, and a limited pool of qualified (or properly trained) employees (Bartlett and Bukvic 2001).

Private enterprises are also confronted with a series of skill-based barriers during the transition period (Aidis 2005). The most common is a lack of business experience as a result of centralized economic planning and the excessive levels of state paternalism that characterized the classical socialist period (Roberts and Tholen 1998).

The lack of business experience limits the survival and growth capabilities of privately owned enterprises and their capacity to serve as economic catalysts and engines of growth as the state sector shrinks during the transition period (Aidis 2005).

The transition from a centralized planned economy to a market-oriented economic model requires a substantial change in the state's role as centralized, bureaucratic coordination mechanisms are replaced by market-based ones (Smallbone and Welter 2010). Even though entrepreneurial activities naturally emerge from the creativity, drive to succeed, and accumulated human and social capital of individuals and groups of individuals during the transition period, the state can play a critical role in shaping the external environment in which the process of entrepreneurship takes place (Smallbone and Welter 2010). In some, if not most, transition economies, state policies, regulations, and actions are a principal element in the “social embeddedness” of entrepreneurship (Smallbone and Welter 2010).

The implementation of an institutionalized policy framework to support and promote entrepreneurship and other forms of private enterprise is a principal requirement for the successful and sustainable development of this vibrant economic sector during the transition (Smallbone and Welter 2010). The state can play a key role in the elimination of excessive and unnecessary barriers to private enterprise creation, the development and creation of an institutional framework that facilitates and fosters the development of private enterprises (mainly through the reduction of excessive taxes), and the formulation of transparent rules and regulations to reduce the risks or uncertainty encountered by the emerging private sector during the transition period (Smallbone and Welter 2010). The expansion of small private enterprises also requires the proper development of institutions and support structures (McIntyre and Dallago 2003). In the case of transition economies, the state can support the expansion of private SMEs through the creation of supporting institutions and the implementation of trade and export promotion programs (Nguyen et al. 2009).

The creation of “alternative spaces” for the emerging private sector since 2010 has improved the availability and quality of goods and services in the Cuban economy, particularly in key sectors such as construction, food preparation and services, personal services, retail, and transportation (Pérez-Villanueva and Vidal Alejandro 2012). Self-employment in the emerging private sector now provides a viable alternative for a growing number of Cuban households

wishing to improve their incomes and living standards, and it serves as an increasingly important source of tax revenues for the state (Mesa-Lago and Pérez-López 2013; Spadoni 2014). The number of self-employed workers in Cuba grew 187.9 percent, from 147,900 in 2010 to 424,300 in 2013; their share of total employment rose from 3.0 percent to 8.6 percent during the same period. Self-employed workers represented 18.3 percent of all nonstate sector workers in 2010; this figure had increased to 32.9 percent by 2013 (see table 6). The remarkable expansion of self-employment in Cuba since 2010 suggests a gradual movement toward a more flexible, less state-centric, and less paternalistic economic model (Mesa-Lago 2012; Spadoni 2014).

However, Cuba's self-employed workers presently face a series of state-imposed regulatory restrictions and prohibitions that limit their economic contributions and growth potential. Even though self-employed workers are allowed to sell goods and services to SOEs, they are not authorized to form joint ventures with foreign investors, which would provide additional access to capital, new technology, and managerial and administrative expertise. Programs to promote the export of goods and services produced by the self-employed and wholesale markets where self-employed workers would be able to purchase essential inputs at market prices using convertible pesos are nonexistent.

Existing restrictions on property rights, limitations on the use of tangible assets as collateral to finance business loans, and the operational and technological constraints that characterize Cuba's state-operated financial system limit its ability to facilitate the mobilization of credit in the Cuban economy. Cuba's self-employed workers lack access to international microfinance (or microcredit) institutions and to capital market instruments such as equity securities, debt securities, asset-backed securities, lease financing, and factoring to finance and expand their operations. Their potential to expand is further hindered by the Cuban government's prohibitions against the "concentration of wealth" (e.g., restrictions on personal property rights and prohibitions against the creation of shareholder-financed corporate entities as part of the emerging nonstate sector).

Self-employed workers in Cuba also face an onerous tax system (Ritter 2011). The current tax system applied to self-employed workers imposes an income tax ranging from 0 percent to 50 percent

of annual income,<sup>4</sup> plus a sales tax of 10 percent (for the sale of either goods or services) and a 25 percent tax for hiring more than five workers. In addition, self-employed workers are required to make periodic social security contributions equal to 25 percent of their personal income (Resolución 298 2011). This extensive tax regime implies that the state still considers self-employed workers in the emerging nonstate sector primarily as a source of tax revenue rather than an engine for economic growth and development.

The approval of Decree-Law No. 289 in 2011 expanded self-employed workers' access to microcredit from state banks and for the first time allowed self-employed workers and other nonstate actors (e.g., small-scale agricultural producers and cooperatives) to open bank accounts to manage their working capital, payroll, and other financial obligations. Despite these positive measures, Cuban self-employed workers are still required to cope with an underdeveloped, state-controlled banking system with limited lending and money-creation capabilities. Cuba's state-owned banking institutions have limited capabilities to promote and deliver innovative financial solutions such as online banking, telephone-based banking services, and automatic teller machines (ATMs); a significant portion of their credit or lending personnel lack the expertise to manage credit or loan portfolios and provide other essential services to self-employed workers; and monetary dualism and the state-controlled exchange-rate system represent major obstacles for the development of the banking and financial services required to support entrepreneurial and self-employment activities (Mesa-Lago and Pérez-López 2013).

Cuba's self-employed workers must also contend with the inexistence of input markets to purchase essential products at competitive prices in regular Cuban pesos from reliable suppliers. Although some experiences with agricultural input markets have been implemented recently—primarily in Havana and two other nearby provinces—with limited success, the creation of input markets where all segments of the emerging private sector can procure essential inputs remains an elusive goal. Self-employed workers and microenterprises continue to rely on purchases in state-owned “hard currency stores” and on the underground economy (or black market) to obtain essential inputs, thereby incurring relatively high search and

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<sup>4</sup> The Cuban tax code indicates that self-employed workers with the following incomes are subject to the following income tax rates: up to 10,000 pesos, 15 percent; 10,000 to 20,000 pesos, 20 percent; 20,000 to 30,000 pesos, 30 percent; 30,000 to 50,000 pesos, 40 percent; over 50,000 pesos, 50 percent.

transaction costs and facing limited options when it comes to sourcing or procuring these inputs (Mesa-Lago 2012).

The state's monopoly on imports, foreign investment, and the formation of joint ventures with foreign investors severely constrains entrepreneurial and self-employment activities in Cuba. Another limitation is the prohibition on direct investment and ownership of tangible assets by Cubans that reside abroad permanently. As Kantis (2005) indicates, the development of government-supported and non-governmental networks is widely used to promote entrepreneurship in developing economies. Facilitating access to seed capital and financing from both government-sponsored investment funds and from private sources of capital is another essential requirement for entrepreneurial development (Kantis 2005). In the case of Cuba, official policies have not addressed this vital tool to encourage and support entrepreneurial activities. Further, prohibitions regarding the diaspora's direct participation in the creation and development of microenterprises prevent the country's emerging entrepreneurial class from having direct access to this important source of seed capital, know-how, and technology transfers.

Cuba's self-employed workers, particularly those involved in retail activities, are also affected by the scarcity of suitable commercial space and by the advanced state of disrepair of state-owned commercial retail spaces (Feinberg 2013). Resolutions 333 and 434, approved in 2011, authorized the leasing (in usufruct) of state-owned retail spaces to newly created "second degree" cooperatives to provide personal services such as barbershops, beauty salons, and car repair shops. Self-employed workers are also authorized to lease retail outlets from the state for up to ten years (Mesa-Lago 2012). Although these measures represent a positive step, the deteriorated conditions of most retail spaces leased from the state, the lack of sufficient credit financing to allow cooperatives and self-employed workers to make the necessary repairs or improvements, and the lack of sufficient retail spaces represents a serious constraint for Cuba's self-employed workers (Feinberg 2013).

Finally, Cuba's self-employed workers still operate under a challenging and hostile business climate. Despite recent economic transformations, Cuban household income and purchasing power remain relatively low compared to the late 1980s. In 2010–11, inflation-adjusted salaries were 70 percent lower than in 1989 (the year before the beginning of the "Special Period" and the economic

crisis caused by the disappearance of the Council of Mutual Economic Assistance and the disintegration of the Soviet Union in the early 1990s) (Mesa-Lago 2012). Self-employed workers and entrepreneurs do not have access to the traditional mechanisms used to finance new business undertakings, such as venture capital, private equity, debt financing, and collateralized lending. As noted previously, they have limited access to microcredit and microfinance; only state-owned banks are authorized to provide limited forms of restricted credit financing to self-employed workers in relatively small amounts (Mesa-Lago 2012). Despite recent transformations concerning property rights, self-employed workers and entrepreneurs in Cuba are still confronted with a wide range of limitations and restrictions designed to prevent the concentration of wealth in the hands of a few (Mesa-Lago 2012; Spadoni 2014). They are also confronted with ambivalent state policies and attitudes toward the self-employed and the emerging nonstate sector.

The economic reforms to promote self-employment implemented in Cuba since 2010 represent a positive step, particularly when compared to the more timid reforms that took place in the 1990s and in earlier periods since 1959. However, the excessive prohibitions and limitations confronted by Cuba's self-employed workers constrain the potential to grow and achieve economies of scale. Eliminating excessive prohibitions and correcting the wide range of distortions that still affect self-employed workers and the rest of the emerging nonstate sector are essential to achieving sustainable economic growth and prosperity in Cuba. Expanding beyond self-employment and truly promoting entrepreneurial development in Cuba to improve the country's economy requires the formulation of a series of comprehensive policy measures designed to expand the social and gender bases from which entrepreneurial activities emerge, increase the quantity and quality of entrepreneurial opportunities, facilitate the development of entrepreneurial networks, improve access to credit and financing, support local and regional entrepreneurial development, and transform the business climate to favor and support the development of entrepreneurial activities (Kantis, Angelelli and Llisterri 2005). To achieve these laudable goals, the state's attitudes and perceptions with regard to Cuba's emerging entrepreneurial class need to be substantially transformed. Rather than treating self-employed workers and private entrepreneurs as a captive source of tax revenue and penalizing them for their success with strict prohibitions against the concentration of wealth, they

should be considered an integral part of a new long-term economic vision in which the private sector is permitted to flourish and make valuable socioeconomic contributions.

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